aspects of the telecommunications industry, the Decree's interpretation is settled.° The Decree's terms are not themselves limited to landline telecommunications (see Section IV.O. defining "telecommunications"), and that understanding was set forth in the Department's fillings prior to the Decree's entry. AT&T and regional company executives committed prior to divestiture that cellular systems would provide equal access. This Court has repeatedly ruled that cellular services are subject to Section II of the Decree, e.g. Mobile Services Opinion, 578 F. Supp. at 645; Triennial Review, 673 F. Supp. at 551; AT&T/McCaw Decision, 154 F.R.D. at 4, and has likewise entered more than 49 waiver orders premised on the proposition that cellular services are subject to Section II. The Court of Appeals has likewise proceeded on that assumption without questioning this premise. United States v. Western Elec. Co., slip op. (D.C. Cir. Nov. 5, 1992) (No. 92-5065) (remanding decision on PacTel's out-of-region cellular service area request for northern Ohio).

Southwestern Bell does not join BellSouth in arguing that Section II does not apply to

⁹ The Tunney Act contemplates the filing and entry of consent decrees in cases in which no testimony has been taken. 15 U.S.C. § 16(a), much less that the issues address had been "fully litigated." If BellSouth were correct, consent decrees otherwise authorized by the Tunney Act could not be enforced.

[&]quot;As set out in the Department's Competitive Impact Statement, the proposed modification would not prohibit the BOCs from offering either cellular radio or land mobile radio. These types of services fall within the definition of exchange telecommunications." Response to Public Comments, 47 Fed. Reg. 23320, 23335 (May 27, 1992); accord, Mobile Services Decision, 578 F. Supp. at 645 ("mobile radio services are 'exchange telecommunications' within the meaning of Section II(D)(3) of the Decree").

AT&T's Memorandum Replying to the Responses to the Court's Order of April 22, 1983, at 5 & n.* (May 19, 1983); Affidavit of Joseph T. Ambrozy (Mid-Atlantic Region), swom to May 18, 1983, p. 9; Affidavit of Delbert S. Staley (Northeast Region), swom to May 18, 1983, p. 15. These representations are quoted at U.S. Mem. 8, Apr. 29, 1994. BellSouth's assertion -- ignoring all these statements -- that "the contemporaneous statements of the parties further confirm that they did not intend to impose equal access obligations and interLATA restrictions on wireless networks" (BellSouth Mem. 8) is at best uninformed.

cellular services -- although it comes close, arguing that concerns about market power in cellular "are illegitimate under the decree." (Southwestern Mem. 15) Southwestern argues that "the wireless switch is not an 'essential,' 'bottleneck,' or monopoly facility."

(Southwestern Mem. 7-11, June 20, 1994)¹² This argument -- if it is meant to suggest that the cellular duopoly is not a source of competitive concern because there are two cellular carriers permitted to operate in any particular market¹³ -- is without merit, whether argued as a matter of decree interpretation or as a matter of competitive analysis.

AT&T made the same argument in support of its effort to acquire McCaw. Memorandum in Support of AT&T's Motion for a Waiver of Section I(D) of the Decree insofar as it Bars the Proposed AT&T/McCaw merger. pp. 50-57 (May 31, 1994) ("AT&T I(D) Mem."). Before announcing its plans to acquire McCaw. AT&T recognized that the integration of cellular and interexchange services without equal access "would extend the cellular exchange duopoly -- and the apparent noncompetitive pricing of cellular 'air time' -- into the provision of interexchange services to all cellular customers." AT&T's Opposition to RBOCs' Motion To "Exempt" Wireless Services from Section II of the Decree. p. 7 (Apr. 27, 1992). Two years later, after AT&T announced its proposed acquisition of McCaw, AT&T offered exactly the opposite view: "These [cellular] systems are not monopolies that can be leveraged into long distance and manufacturing markets." AT&T I(D) Mem. 52.

Southwestern argued to the FCC that it would promote competition if the cellular duopolists were awarded all of the new PCS spectrum. "[A] choice among service providers stimulates and ensures competition. . . . [A] choice would exist . . . because there are already at least two such providers in each market." Comments of Southwestern Bell Corp., In the Matter of Amendment of the Commission's Rules to Establish New Personal Communications Services. p. 12 (F.C.C. Nov. 9, 1992) (Gen. Docket No. 90-314). Southwestern makes the same claim here. "[N]o provider has the ability to leverage anything at all, regardless of its incentives. There is always a competing mobile provider down the road." Southwestern Mem. 12. As we show below, two providers is insufficient for genuine competition in these markets, and Southwestern itself observes internally that these duopolies are "highly attractive" because of their "absence of significant price competition." [SWB 218486]

The BOC documents quoted in this memorandum, and exhibits derived from cellular company data cited in this memorandum, have been submitted to the Court under separate cover. Documents produced to the Department in its investigation are grouped by producing party, and within those groupings by document number, and are cited in this memorandum by party name or abbreviation and document number. The exhibit volume has been provided to the Court. It will be provided to any party to this proceeding that signs the non-disclosure agreement the Department submitted to the Court today. The Department plans to file the exhibit volume and to make it available to the public on August 1. We request that any producing party objecting to disclosure of a particular document do so by July 27 so that, if warranted, any confidential documents will be filed under seal.

Landline local exchanges can be used to impede competition between cellular providers. Triennial Review, 673 F. Supp. at 551; see pp. 40-42 below. Cellular carriers and interexchange carriers both rely on local exchange facilities for access, interconnection and transport. The Court has recognized that the dangers from BOC control of an out-of-landline-region cellular system are no greater than BOC control of in-region cellular systems, but has required both to provide equal access and prohibited both from providing interexchange services. United States v. Western Elec. Co., 1986-1 Trade Cas. ¶ 66,987, at 62,055 (D.D.C.) (PacTellCI'), rev'd on other grounds, 797 F.2d 1082, 1089-91 (D.C. Cir. 1986), cert. denied sub nom. US West Inc. v. United States, 480 U.S. 922 (1987). Applying the Decree's equal access restrictions only to the "landline switch," as the movants propose, would be insufficient to prevent abuse of the landline exchange. 14

There is no reason to believe that the Decree's purposes end where the local landline exchange ends. The Decree's terms plainly apply to cellular exchanges -- as this Court's latest opinion and eight years of consistent application of the Decree to out-of-region BOC exchange services makes clear. This Court has specifically applied Section II's interexchange prohibition and other Decree requirements to an out-of-region cellular system, notwithstanding the fact that the BOC did not control local exchange facilities in the cellular service area.

PacTellCI, 1986-1 Trade Cas. at 62,060. Subsequent orders, including orders sought by BellSouth and Southwestern, have also applied Section II to cellular exchanges where the

¹⁴ By contrast, the Department's proposed order adds to the protections against discrimination by the landline exchange by prohibiting the BOCs from building and owning their own interexchange facilities, and limiting them to the resale of switched interexchange services obtained from multiple vendors. See p. 37 & n.50 below.

BOC does not provide landline local exchange service.15

Attempts to limit the applicability of the Decree to the local landline "bottleneck monopoly" read the Decree too narrowly. This request for a modification turns on whether the modification is necessary to the public interest. *Rufo*, 112 S. Ct. at 760. The determination of the public interest, in this specific context, asks whether eliminating equal access from cellular systems will reduce competition in interexchange markets. The cellular carriers' duopoly status gives them the monopoly or market power -- terms the Court of Appeals has used interchangeably. -- and that market power makes abuse of the cellular exchange an issue of competitive concern.

¹⁵ Order, Sept. 27, 1987 (Southwestern acquisition of Metromedia); Order, Oct. 31, 1986 (BellSouth joint venture with MCCA).

¹⁶ Cellular exchanges are "bottlenecks" if they can be used to prevent or deter a customer's access to interexchange carriers, since customers have to go through one of the two cellular exchanges to reach their interexchange carrier. See pp. 19-23 below.

[&]quot;Whatever it means to 'leverage' one's monopoly power, the DOJ is surely correct that no damage can come to competition -- through 'leverage' or otherwise -- can occur unless the BOCs can exercise market power." Triennial Review, 900 F.2d at 296 (emphasis added).

Standard economics and antitrust texts recognize that monopoly power and market power are functionally identical concepts. "Pure monopolists, oligopolists and monopolistic competitors... all possess some degree of power over price, and so we say that they possess monopoly power or market power." F. Scherer & D. Ross, Industrial Market Structure and Economic Performance 17 (3d Ed. 1990) (hereafter "Scherer & Ross"); accord, e.g., 2 P. Areeda & D. Turner, Antitrust Law ¶ 504, 507, at 325, 330 (1978) (hereafter "Areeda & Turner"); D. Carlton & J. Perloff, Modern Industrial Organization 97 (1990) (hereafter "Carlton & Perloff"). Any purported distinction between "monopoly power" and "market power" would hardly be meaningful. See, e.g., Hay, "Market Power in Antitrust." 60 Antitrust LJ. 807, 817-21 (1992). Professor Hay discusses varying definitions of "market power" and "monopoly power" by courts and commenters, noting that at best the distinction appears to be only that "monopoly power" is taken to mean "a high degree of market power." Id. at 817, 818 n.44, citing Landes & Posner, "Market Power in Antitrust Cases," 94 Harv, L. Rev. 937, 952-60 (1981). Professor Hay concludes that "the key to monopoly (or market) power is the power to control price (i.e., the power to charge prices above the competitive level), and the power to exclude competition is an ingredient of that power to control price." Hay, 60 Antitrust LJ. at 821.

C. Allowing a BOC to Provide Interexchange Service from Cellular Exchanges.

Without Equal Access. Would Reduce Competition for Cellular Interexchange Service.

The crux of the BOCs' original waiver application to the Department, seeking the removal of equal access and the unrestricted removal of the interexchange prohibition on their wireless businesses, the BOCs argued that "competition in radio services is extremely robust," that "competition is flourishing in mobile service markets," and that "without a showing of market power, the Bell companies are plainly entitled to the relief they seek."

Specifically, all of the BOCs argued in 1991, and the movants argue again, that equal access raises prices for long distance by permitting non-BOC cellular carriers to buy long distance in bulk but charge retail rates; if equal access were eliminated, the cellular duopolists would purportedly compete with each other on long distance, driving down the price. BOC Mem. 45 (Dec. 13, 1991); BOC Reply Mem. 21-26 (Aug. 3, 1992); BellSouth Mem. 22-23; Southwestern Mem. 27. To support this logic, it must be shown that the cellular duopoly is competitive. The facts, however, are just the opposite. Cellular duopolists plainly have market power in cellular service, and the major premise of the BOCs' argument therefore fails. It follows inexorably that if the BOC has market power in cellular service, and can exclude competitors in long distance, it can exclude the benefits of competition that those competitors bring.

Memorandum of the Bell Companies in Support of their Motion for Removal of Mobile and other Wireless Services from the scope of the Interexchange Restriction and Equal Access Requirement of Section II of the Decree, pp. 6, 16 (Dec. 13, 1991). Contrary to that last claim, the burden is on the *movani* to show a lack of market power. *Rufo*, 112 S. Ct. at 760 ("a party seeking a modification of a consent decree bears the burden . . . "); *Triennial Review*, 900 F.2d at 296 ("the ultimate burden under section VIII(C) remains on the petitioning BOC").

1. Cellular Exchange Service Markets are Not Competitive Today.

These cellular systems have substantial market power. The FCC has so concluded on four separate occasions in the last three years.²⁰ and the General Accounting Office has reached the same conclusion.²¹ The Department's extensive investigations into the cellular industry likewise indicate that cellular duopolists have substantial market power: "the ability to raise prices or restrict output." *Triennial Review*, 900 F.2d at 296.

The basic structural problem with cellular markets is well known -- the fact that they are and have been duopolies with (at least until very recently) absolute barriers to entry.

While the FCC's decision to issue two cellular licenses -- rather than only one -- was motivated by a desire to stimulate competition, Cellular Communications, 89 F.C.C.2d 58, 61 (1982), two-firm markets are not particularly competitive.²² The noncompetitiveness of two-

FCC Equal Access NPRM. ¶ 36; Notice of Proposed Rulemaking and Tentative Decision. In the Matter of Amendment of the Commission's Rules to Establish New Personal Communications Services. 7 F.C.C. Rcd 5676, 5702 (1992) ("PCS NPRM"); Report and Order. In the Matter of Bundling of Cellular Customer Premises Equipment and Cellular Service, 7 F.C.C. Rcd 4028, 4029 (1992); see also Second Report and Order. In the Matter of Amendment of the Commission's Rules to Establish New Personal Communications Services, 8 F.C.C. Rcd. 7700, 7744 (1993) ("FCC PCS Order"). The FCC's recent decisions -- particularly its 1993 PCS Order -- were entered after and despite the cellular industry's intensive (but unpersuasive) efforts to argue that the cellular duopoly is competitive. See Reply Comments of the Department of Justice, In re Personal Communications Services, at 17-22 (F.C.C. Jan. 19, 1993) (citing and rebutting arguments).

Report to Hon. Harry Reid, U.S. Senate, Concerns About Competition in the Cellular Telephone Service Industry, pp. 2-4 (Gen. Acctg. Ofc. 1992).

Economic theory generally predicts that prices will be higher and output less in markets with fewer rather than more competitors, or in markets that are more highly concentrated, absent mitigating factors. See, e.g., Scherer & Ross at 277-78; 4 Areeda & Turner, ¶ 910b at 55 ("there is general agreement that beyond some point the smaller the number of firms and the larger the share of the market dominated by one or a relatively few firms, the greater the likelihood of substantial departures from competitive performance, particularly with regard to price"); Stigler, "A Theory of Oligopoly, 72 J. Political Econ. 44-61 (1964). Studies indicate that markets dominated by duopolies are particularly troublesome. "Large market shares for the two leading firms seem most decisive for industry pricecost margins, with a depressing effect from a sufficiently large third share." Kwoka. "The Effect of

firm markets is exacerbated here by the overlapping alliances of the cellular carriers, so that firms that "compete" with each other in one market are partners in another.²³

The BOCs' internal documents, written at the same time that they were telling the Department that cellular is "robustly competitive," demonstrate that in the BOCs' view cellular is comfortably noncompetitive. Southwestern, which argues that "wireless markets today are vigorously competitive" (SWB Mem. 11), observed in 1991 -- the year it and the other BOCs filed for this waiver -- that there was an "absence of significant price competition" in cellular, and that the market is "highly attractive" for that reason. [218486] Southwestern further observed:

The FCC predicted sufficient levels of rivalry from a duopoly. In actuality, the two players in each market have been able to avoid serious competition in this rapid growth environment. [218492]

In the current environment, characterized by rapid growth and limited rivalry, relative position is less relevant than in mature, competitive industries. . . . In the future, as new competitors enter the market and subscriber growth eventually levels off, positioning will become increasingly important. [218517]

More recently, Southwestern observed that "new industry entrants will not be effective competition before 1996" (emphasis in original). Southwestern assessed that threat of new entrants as "medium," and the bargaining power of buyers as "low" -- recognizing that the

Market Share Distribution on Industry Performance," 61 Rev. Econ. & Statistics 101, 108 (1979). Many studies have found a statistically significant positive correlation between price and market concentration. See Schmalensee, "Inter-Industry Studies of Structure and Performance," in 2 R. Schmalensee & R. Willig, Handbook of Indus. Org. 987-88 (1989) (collecting studies); L. Weiss. Concentration and Price 268 (1989) ("overwhelming support" for concentration-price hypothesis).

²³ For example, AirTouch (the former PacTel cellular properties) is a partner with McCaw in operating a cellular system in San Francisco, and competes against a McCaw/BellSouth system in Los Angeles. BellSouth, McCaw's partner in Los Angeles, is McCaw's rival in Miami. Southwestern Bell partners with McCaw in operating the "Cellular One" marketing organization, but competes against McCaw in Dallas, St. Louis and Kansas City.

"threat of substitute products or services [is] low" and that "extensive time periods for regulatory determinations, license awards and infrastructure construction will occur prior to the emergence of effective competitors." [SWB 203264-65]

Other BOCs have made similar observations about cellular markets:

The duopoly structure is a continuation of the status quo. . . . Under this scenario, competitive intensity is greatly reduced. This enables direct cellular competitors to improve margins In fact, the most significant element of this structure is the probability that profit margins for all competitors would tend to increase under prolonged restricted competition. (AM00385-86, Ameritech, July 1990)

Cellular industry--unusually attractive structural characteristics--government-mandated duopoly providing very high barriers to entry--essentially unregulated with regard to rates and rate of return . . . overall competitive rivalry is low to moderate . . . to date little competition on service pricing. (PT00008-12, PacTel, Sept. 1, 1987)

The burgeoning demand for cellular service when coupled with the duopolistic market structure mandated by the FCC has led most investment analysts to conclude that the cellular industry will be even more profitable than cable TV, to which comparisons are constantly made. . . . While BAMS believes that providing quality cellular service requires considerably more investment in the infrastructure of the business . . . than does cable, it must be acknowledged that the investment community has been generally correct in forecasts of thriving cellular revenues. It is also important to note that increased market penetration in the absence of downward price pressures will buy alot of infrastructure. (106707, Bell Atlantic 1989)

In June 1992, six months after filing this waiver application asserting that cellular was "robustly competitive," US West observed: "Current duopoly structure and market growth limits competitive intensity." [USW 875]

Cellular carriers often have the ability to *raise* prices for cellular service, particularly by raising prices in a manner that is less visible to the customer. A review by Southwestern Bell of its cellular markets demonstrates the phenomenon:

Chicago has made a number of changes to improve subscriber revenue. These include: November 1987--changed prime hours from 8 am to 8 pm to 7 am to 9 pm; March 1990 began charging for 'ring time'; . . . December 1990 increased foreign

roamer rates from 50e/min to \$2/day and 75e/min: May 1991 increased basic monthly access charge to \$19.95. This impacts about 40% of the base. For the future, with rates in general being so low, it is our intent to continue to increase rates. . . . We are also evaluating charging customers for the Telco interconnection fees associated with their usage. [203139]

Over the past few years. Boston has initiated several key rate changes to improve subscriber revenue per customer. The changes include the following: July 1989 roamer surcharge introduced; April 1990 changed the billing increment from the 6-second rounding to full minute; July 1990 introduced a free of peak plan with a premium monthly access charge; June 1991 increased foreign roamer rates 32%; June 1991 raised monthly access charge \$2. . . . [A]t this writing, while we are implementing a rate increase in June 1991, Nynex has filed a tariff which would lower rates and price their plans below ours across the board. Their actions seem illogical and appear to contradict the steps needed to offset declining customer usage. . . . As for the future, SBMS believes there are other opportunities to increase rates in Boston, somewhat dependent on our competitor. . . . With monthly access charges relatively low, SBMS will continue efforts to move this fixed charge upward. [203140-41]

The Washington/Baltimore property historically has had the highest subscriber revenue per customer of all the SBMS properties. . . . Washington/Baltimore was one of the last SBMS properties to fall below the \$100/month average subscriber revenue. . . . Plan F, a plan designed to add new customers quickly . . . resulted in a large addition of customers. [but] it was priced so inexpensively . . . that it drove the Washington/Baltimore average downward. Plan F has been subsequently dropped. Despite the obvious failure of Plan F, Washington/Baltimore has introduced a number of changes to improve subscriber revenue per customer . . . : Changed the billing increment to full minute rounding; increased roaming rates; . . . changed peak hours . . . ; increased access charges on low end plans. Washington/Baltimore's future changes will focus on gradually increasing rates. This will be accomplished mostly through higher access charges and possibly increased per minute rates." [203141-42]

Dallas subscriber revenue per customer has always been good for a large market. . . . Over the last couple of years, the Dallas property has been the SBMS leader in implementing changes to improve subscriber revenue. Subscriber revenue per customer has declined 13.8% since 1988 while peak minute usage per customer has dropped 24%. Major factors contributing to this performance are as follows: Changed from 30 second to full minute billing increments; raised access charges on economy and basic plans; introduced 'free off-peak' which initially resulted in higher peak usage. Once established, eliminated the offering from low-end plans; increased foreign roamer rates . . . Dallas has also increased activation fees, voice mail rates, and other miscellaneous charges. . . . Dallas is also reviewing charging customers the interconnection fees charged by the Telco associated with customer usage. In Dallas, this could be as much as 2g/min, which would be a significant boost to subscriber

revenue. [203143-44]

[In 1]ate 1989 [in Oklahoma City.] . . . roaming rates were increased. In early 1990 billing increments were changed to full minute rounding. [203146]

Similar to the other SBMS markets, the West Texas properties have been gradually increasing rates by changing the billing increment, raising access charges and increasing roamer rates. Additional increases in rates will be gradual as in the past so as not to create a competitive disadvantage. Further upward movement of the access charges is the most likely course with the de-emphasis of the economy plans close behind. [203146-47]

Examination of pricing data shows a similar ability to raise prices. A look at BellSouth's pricing practices in Florida, a state in which BellSouth claims to be at a competitive disadvantage against its A block competitor, McCaw, is most revealing. Over the 1990-1993 time period in Miami, the state's largest market, BellSouth's average per minute revenues for cellular service rose 21 percent, while its market share of service revenues rose from 48 percent in 1990 to 50 percent in 1993, despite McCaw's larger share of minutes of use. For the years 1991-1993, BellSouth's per minute revenues were two percent, nine percent, and 15 percent higher than McCaw's, respectively (in 1990, BellSouth was one percent lower). In Jacksonville, over the same 1990-1993 period, BellSouth's per minute revenues rose more than 30 percent, while McCaw's per minute revenues varied from

The simplest way to examine cellular service prices is to divide service revenues by minutes of use. This calculation permits an observation undistorted by pricing plans and the like, and often is used by the cellular carriers themselves to measure their performance. The pricing information in this memorandum is based on comparing service revenue and minutes of use, based on data provided to the Department by the BOCs and McCaw in connection with our investigations, and is submitted as Exh. 7.

²⁵ See, e.g., BellSouth Corporation's Opposition To AT&T's Motion for a Waiver of Section I(D) of the Decree Insofar as it Bars the Proposed AT&T-McCaw Merger, pp. 18-22 (June 28, 1994) (claiming that BellSouth is at a competitive disadvantage due to McCaw's "City of Florida" plan that allows its subscribers to have service throughout McCaw's service areas within the entire state at a single "local" price).

16 to 25 percent less over the same period. Despite this disparity, BellSouth retained the greater share of both service revenue (1990's 66 percent share has not surprisingly dropped to 1993's still impressive 55 percent share) and minutes of use.

Nonetheless BellSouth claims that it is at a competitive disadvantage to McCaw by reason of the Decree restrictions. (BellSouth Mem. 28, 33, 41) The Decree does not appear to be preventing BellSouth from charging higher prices than does its rival.

2. Given the BOCs' Market Power in Cellular Service, Eliminating Equal Access Will Reduce Competition in Cellular Long Distance.

Today these cellular systems provide equal access, as the Court has required of BOC cellular systems since 1983. A contrary "development would have been entirely inconsistent with the terms and purposes of the decree, and the Court would not have authorized it."

Mobile Services Decision, 578 F. Supp. at 647. As a result, their subscribers can choose their long distance carrier and have the benefit of whatever competition is present in the long distance market.

Cellular systems "can prevent their customers from reaching the interexchange carriers of their choice by programming their switches to send all long distance [calls] to one carrier." Therefore, the operators of those cellular systems could reduce competition for long distance service by denying access to competing carriers and requiring cellular subscribers to obtain long distance at prices not set by competition between those competing carriers, subject to whatever constraint exists through competition in the cellular market. As

Mandl Aff. § 6, submitted with AT&T's Motion for a Waiver of Section I(D) of the Decree insofar as it Bars the Proposed AT&T-McCaw Merger (May 31, 1994). Accord, BOC Mem. 9-10.

the BOCs have recognized, non-BOC cellular carriers have done just that:²⁷ BellSouth and Southwestern seek to do the same.

The Department's investigation indicated that cellular subscribers value the choice that equal access gives them. This is particularly true for larger businesses, which seek to connect their cellular services to private networks offered by interexchange carriers. By doing so, the business user obtains not only access to the features of the private network, but also the very substantial discounts on long distance prices that are sold as part of that service. These are the very discounts that the BOCs seek to obtain (BOC Mem. 26, June 20, 1994); today they can be obtained by customers of equal access systems, but generally not by others. Indeed the availability of equal access from BOC systems has pressured non-BOCs (notably McCaw) to offer connections to large customers' private networks, in order to retain their business. Businesses that do not obtain cellular service from equal access cellular systems have no access to these discounts and services, and have been frustrated in their efforts to reduce their cellular long distance costs. While the largest businesses might have the leverage with their cellular providers to gain access for their private interexchange services, smaller businesses

²⁷ E.g., BOC Reply Mem. 23-24 (Aug. 3, 1992).

The one segment of the long-distance market that appears most competitive is the market for large customers." P. Huber, M. Kellogg & J. Thome, The Geodesic Network II: 1993 Report on Competition in the Telephone Industry 3.17, see id. 3.39-44 (describing means whereby interexchange carriers discount rates to large users); see also Kelly Aff. 26-27 (Apr. 29, 1993), submitted with Letter to Richard L. Rosen from Michael H. Salsbury (MCI), Apr. 30, 1993.

²⁹ For example, Dow Chemical pays 25 to 50 percent more for cellular long distance than for landline long distance because its cellular carrier does not provide equal access. Dow chose to pay these higher prices rather than have its sales people change cellular telephone numbers, which they would have to do if Dow changed carriers. Jacobs Aff. 3-5 (Exh. 8 hereto) "Dow Chemical believes that when cellular providers offer Dow Chemical the option to select the carrier from whom the company purchases long distance cellular service, Dow Chemical benefits in the form of lower cellular long distance prices." *Id.* at 5.

and individuals cannot get those benefits -- except where equal access requires it.

Southwestern also argues that, even if it has market power, it would have no incentive to raise prices of long distance. "[A] hypothetical provider of mobile services that enjoyed real market power would simply exploit that market power directly; there would be no advantage in attempting to leverage that power into ancillary services such as mobile long distance service or mobile information services." (Southwestern Mem. 8; see also BOC Mem. 28) This attempt to argue that there is only "one monopoly rent" is contrary to fact and well reasoned theory.

The fact, as indicated in Southwestern Bell's own documents, is that a successful strategy for raising prices is to focus on ancillary services. See pp. 16-18 above.

Southwestern Bell has found that it can "aggressively chang[e] elements of subscriber revenue to mitigate the effect of lower customer usage" by raising the costs of ancillary services, for example, by "increased monthly access charges. . . . slightly higher roaming, . . . eliminating 'night hours' and extending peak hours in many of the markets." [SWB 203136-37] If Southwestern Bell finds that the best method of increasing revenue is to raise the price of roaming rates and access charges, it stands to reason that it would find it equally feasible and attractive to raise the rates of long distance charges.

Southwestern's "one monopoly rent" argument is contrary to theory as well as fact.

³⁰ Southwestern quotes AT&T's economists, who made the same argument in support of AT&T's efforts to acquire McCaw: "Since the monopolist can only charge the monopoly rent once, it has no generally applicable incentive to favor its affiliate if another competitor can provide the good or service more efficiently." Southwestern Bell Mem. 9, quoting Willig & Bernheim Aff. 9. The argument that vertical integration cannot increase a monopolist's profits is often attributed to Robert Bork, who expanded upon economic theory and popularized this argument among antitrust lawyers. R. Bork, The Antitrust Paradox 229 (1978); see Scherer & Ross at 522.

The theoretical model on which Southwestern relies depends, in general, on the presence of many key and restrictive conditions, at least *four* of which are not present here. First, as Southwestern Bell acknowledges, the theory is limited to unregulated monopolists. Cellular duopolists are not universally unregulated; in California, home of 20 percent of the nation's population, cellular prices are regulated.³¹ Second, the theory requires that the two inputs (here, cellular service and long distance service) be used in fixed proportions; if the integrator or user can vary the proportions (by making more or fewer long distance calls) the general argument fails. Third, the argument does not apply where the firm cannot price discriminate in the downstream market — the long distance market — without vertical integration. Fourth, and most important, the argument applies only to the situation in which a monopolist is integrating with a firm in a competitive market; here we have decidedly imperfect competition in cellular, and (as the BOCs acknowledge) imperfect competition in long distance. The "one monopoly rent" model does not speak to the situation of integrating oligopolists.³²

The theory embraced by Southwestern argues that there are no means (except efficiency means) by which monopolists can vertically integrate and increase their monopoly profits. See R. Bork, The Antitrust Paradox, at 229. That theory has been rejected by economists of all persuasions, who recognize that there are conditions under which a

Cal. Pub. Util. Code § 401 et seq.: 17 CPUC 2d 499 (1985) In California, "the Public Utilities Commission has jurisdiction over rates charged for cellular service." Cellular Plus, Inc. c. Superior Court, 18 Cal. Rptr. 308, 311 (1993). Cellular carriers must file financial statements, receive approval for wholesale rate increases, and receive approval to install new transmitter sites. See also BOC Mem. 28 ("half of the States do not regulate cellular or paging providers at all"; the other half presumably do, even if they "typically impos[e] no price regulation at the retail [i.e., reseller] level"). Regulation of BOC landline exchanges further distorts the "one monopoly rent" argument.

³² Cariton & Perioff 517, 510.

monopolist or oligopolist can vertically integrate and increase its monopoly profits. And it is directly contrary to the observable facts here: Southwestern has raised prices of "ancillary" services, such as roaming, rather than raise more visible prices (see SWB 203136-37), and the BOCs all observe that non-equal access carriers, such as McCaw, charge top dollar for long distance services that are "ancillary" to their cellular service, rather than simply raising the price of cellular service.

D. The Movants Have Not Demonstrated any Significant Changed Circumstances
Warranting Relief.

Under Rufo, the party seeking modification "bears the burden of establishing that a significant change in circumstances warrants revision of the decree." 112 S.Ct. at 760. As this Court noted, a significant change is a "significant change in factual conditions or in law" that could not have been anticipated at the time the Decree was entered. AT&T/McCaw

Decision, 154 F.R.D. at 7-8, quoting Rufo, 112 S. Ct. at 760.

Since the Court rejected the BOC's application to provide interexchange service from cellular exchanges without equal access in 1987, *Triennial Review*, 673 F.Supp. at 551, the BOCs must show that a significant change since then would warrant their instant motion to provide such service. The changed circumstance necessary, and which has not occurred, would be a substantial increase in competition in wireless services, so that cellular carriers would not have significant market power. *See Decree Opinion*, 552 F. Supp. at 195. They have not established that there has been such a change.

³³ Cariton & Perioff 510; R. Warren-Bolton, Vertical Control of Markets 64, 80 (1978); J. Tirole, Theory of Industrial Organization 179-80 (1988); Scherer & Ross at 521-22.

The movants point to two developments to support their argument that there has been a significant change in circumstances. First, they argue that AT&T's acquisition of McCaw, if permitted by this Court and the FCC, will substantially change the cellular business by permitting entry of the nation's largest long distance carrier into the local cellular exchange business. This entry, they argue will place the BOC cellular systems at a substantial competitive disadvantage, thereby harming consumers. Second, they argue that entry into the wireless business is imminent in the form of SMR and PCS. They suggest that entry of these new providers will eliminate the need for equal access to preserve competition in the provision of long distance services to cellular subscribers. Neither of these developments justify the relief the BOCs seek.

The proposed final judgment that the Department has negotiated with AT&T refutes the BOCs' argument that AT&T will have different equal access rules. Rather, that proposed decree and the order proposed for the BOCs' motion applies consistent rules to both the BOCs and AT&T. The terms of the AT&T/McCaw judgment, if approved, would expand the scope of equal access to apply to McCaw cellular exchanges that do not currently provide equal access. As a result, that judgment will eliminate the competitive disadvantage that the BOCs claim they currently face. Ironically, granting the BOCs' motion would create the harm they claim they want to end — placing a cellular provider in a position where it must provide equal access while competing with a provider that need not do so.

The BOCs' other contention is likewise without merit. As yet, there are no SMR or PCS providers of wireless telephony generally available today. It is, of course, possible that at some point these new technologies will offer wireless service in competition with today's

cellular duopolists. When it will happen and what effect, if any, it will have on competition in the market for cellular telephone service is now unknown.

The FCC has not yet assigned PCS licenses. Indeed, the Commission has not yet even said when licenses will be awarded. Once the licenses are assigned, the licensees must take a number of time-consuming steps before they can offer service. They must develop the necessary technology, obtain financing and build networks. The very nature of PCS, including the services to be provided and the technology to be employed, is not yet settled. BellSouth itself told the FCC that "cellular systems and new PCS licensees will be competitors only to a very limited degree." It is, of course, impossible to say how long it will take to develop PCS, but it appears that it will be some time before PCS service will have any impact on competition for wireless telephony. Any assertion that PCS has changed the competitive environment is premature at best.

Several firms are in the process of accumulating radio spectrum currently allocated to Special Mobile Radio (SMR) with the stated intention of offering wireless telephone service. While that service might be closer to deployment than PCS, when and if it will be available is not yet known. SMR providers currently offer a dispatch service that is functionally

³⁴ See Peterson, "Positioning PCS on the Telecom Landscape," Telephony, 26 (December 13, 1993). Mr. Peterson is Manager of Market Research at Motorola's General System Sector, a prospective PCS manufacturer, and is positioned to be well informed on PCS.

³⁵ PCS Comments of BellSouth. In the matter of Amendment of the Commission's Rules to Establish New Personal Communications Services 48 n.96 (F.C.C. Nov. 9, 1992). BellSouth relied on a forecast by Telocator that "shows cellular service prices in 2002 remaining 14-67% higher than the price for 'personal telecommunications service' and as much as three times as expensive as telepoint service." Id.

distinct from cellular telephone service.36

Three firms are attempting to convert SMR spectrum to wireless telephone use.

Nextel Communications Inc. is the only firm that has begun construction of an SMR system that would provide cellular-like telephony service. Nextel has noted that it could still face a number of difficulties, including having substantially less radio spectrum than that allocated to cellular telephone providers (which could cause its costs to be substantially higher), a limited number of equipment suppliers and a current inability to offer nationwide service. Nextel's filing also indicates that its service might not have adequate voice quality. 37

This voice quality problem has also been noted by McCaw's Chief Operating Officer. who testified that Nextel's voice quality is currently poor. Mr. Barksdale noted that Nextel might have to halve its capacity to improve its voice quality, further increasing its costs.³⁸

As with PCS, the BOCs' assertion that SMR deployment constitutes a significant change in circumstances is, at best, premature.

Dispatch service is used by fleet dispatchers, such as those that issue assignments to taxicabs and utility repair trucks. Some SMR providers offer interconnection with the public switched telephone network; such service, however, is far less convenient that cellular service and is used infrequently. SMR customers who need mobile telephone service usually have SMR and cellular telephone equipment in their vehicles.

³⁷ Nextel Communications, Inc., Securities and Exchange Commission, Form S-3, pp. 28, 36 (February 8, 1994).

Deposition of James Barksdale, June 28, 1994, 218-221 (Exh. I hereto). Mr. Barksdale's deposition was taken during the Department's investigation of the AT&T/McCaw transaction. Presumably, Mr. Barksdale had an incentive to emphasize the likelihood of Nextel's success as an entrant into the mobile telephone business.

II. THE BOCS' RESALE OF SWITCHED INTEREXCHANGE SERVICES TO THEIR CELLULAR SUBSCRIBERS, SUBJECT TO SUFFICIENT EQUAL ACCESS SAFEGUARDS, SHOULD NOT RESULT IN AN ABILITY TO RAISE PRICES FOR INTEREXCHANGE SERVICE.

The BOCs' generic wireless waiver motion, unlike the motions by BellSouth and Southwestern, does not seek a modification of Section II's equal access requirement. The only modification sought is that of Section II(D)(1)'s interexchange prohibition. In light of AT&T's opposition, the standard for review is that of Section VIII(C): whether the BOCs have demonstrated that "there is no substantial possibility that [they] could use [their] monopoly power to impede competition in the markets [they] seek to enter." In the Court of Appeals' formulation, that standard requires the BOCs to demonstrate that they will not "have the ability to raise prices" in those markets. 900 F.2d at 296. The United States believes that, in an environment in which appropriate equal access safeguards prevent discrimination against interexchange competitors, that showing is made.

A. BOC Entry as an Additional Choice, Subject to Equal Access. Should Not Result in an Ability to Raise Prices.

As discussed above (pp. 13-23), the reason that the elimination of equal access would reduce competition is that it would prevent cellular customers from obtaining the benefit of whatever competition there is in the interexchange market.³⁹ By contrast, if genuine equal

There plainly is some competition in interexchange services, notwithstanding the BOCs' arguments. Indeed their arguments are premised on the proposition that competition in bulk long distance, which they seek to purchase, drives prices far below AT&T's regulated Tariff 1 rates. See p. 20 & n.28 above. Even at the retail level, the benefits of divestiture and the equal access regime it created have substantially reduced long distance prices, as the Court has often noted. E.g., AT&T/McCaw Decision, 154 F.R.D. at 10.

access can be preserved, it seems unlikely that BOC entry into cellular long distance, in competition with existing providers, would reduce competition in that market. Their entry might be competitively neutral, or might actually result in lower prices; there does not seem to be a clear reason that -- again, subject to genuine equal access -- their entry might raise prices.

The BOCs will enter the long distance market with no market share, no existing long distance customers, and no ability to convert their current cellular customers to their own long distance services -- except by persuading customers that the BOC offers a better service or the same service at a lower price. To the extent the BOCs offer service at prices below AT&T Tariff 1 prices.⁴⁰ their customers (and the customers of other interexchange carriers, who may either demand lower prices or switch to BOC long distance service) benefit. To the extent the BOCs offer service at prices higher than AT&T's highest rates, customers have alternatives.

The interexchange carriers' arguments against the waiver, as made to the Department during its investigation, do not challenge this proposition. They challenge instead whether the BOCs' provision of access to itself and its competitors can ever be considered "equal," and whether the BOCs' control of the landline exchange overwhelms the analysis. The adequacy of equal access (under the Department's proposal, rather than under the BOCs') is discussed at pp. 29-40 below; whether control of the landline exchange dictates a different

The rates contained in AT&T's Tariff No. 1 (sometimes referred to as "Basket 1" or "MTS" rates) are AT&T's "undiscounted" retail rates, from which AT&T offers discounted rate plans. MCI. Sprint and other long distance carriers likewise offer discounted rate plans based on volume.

⁴¹ AT&T's Further Opposition to RBOCs' Motion to Exempt "Wireless" Services from Section II of the Decree, pp. 11-14 (May 3, 1993); Kelly Aff. 19-21 (MCI submission Apr. 30, 1993).

result is discussed at pp. 40-42 below.

If genuine equal access is provided, the BOC will not have an unfair advantage over its competitors by reason of its providing access to itself and to its competitors. If they have an equal chance to gain customers, the BOCs' competitors will not be foreclosed from the cellular exchange. If the BOCs can only gain business by charging lower prices, that would not seem likely to lead to the higher prices that the Court of Appeals noted was the test for Section VIII(C). These arguments may seem tautological, but their import is that the focus of the inquiry should be on the question whether, and under what conditions, a BOC cellular system can provide access to itself and its competitors without creating a substantial risk that it will discriminate in providing that access. We now turn to that question.

B. Appropriate Safeguards are Required To Protect Against Discrimination in Access or Presubscription by the Cellular Exchange Operator.

The structure of the Decree rests on equal access. AT&T's discrimination against competing long distance carriers formed the basis of the antitrust violation, and preventing discrimination by the exchange access provider was and is the key to allowing competitive long distance markets to develop. *Decree Opinion*, 552 F. Supp. at 165. Recognizing that merely enjoining discrimination would be insufficient to prevent that discrimination, the Decree required a permanent separation of AT&T's exchange and long distance businesses, id. at 165, 172, and prohibited the Bell companies from integrating into the long distance business. Id. at 177. However, the Court recognized that the BOCs might lose their monopoly power over time; the Court therefore added Section VIII(C) to the Decree, to permit entry by the BOCs when that entry would be unlikely to reduce competition. Id. at

To determine whether that entry is now appropriate, the Court should consider whether sufficient safeguards exist or have been proposed to prevent the danger that the access provider, in providing access to itself as well as its competitors, could discriminate against those competitors in the provision of exchange access.⁴² As in 1982, simply enjoining discrimination is insufficient protection; specific proscriptions are appropriate in light of the dangers presented, and those proscriptions should be adopted in a manner that will make detection and prosecution of any violations reasonably likely.⁴³

The Department has considered these questions in the limited context of cellular services, and believes that appropriate safeguards can be devised -- although the Department also believes that the safeguards offered by the BOCs are insufficient, and recommends additional safeguards to prevent the discrimination that could reduce competition in cellular interexchange markets.⁴⁴

The BOCs have said that "for the most part, [the Department's] conditions and

⁴² As noted above, wireless access markets cannot today be considered to be especially competitive. Those markets are nonetheless not nearly as tightly controlled as landline exchange access markets, where local telephone companies appear to have well over 90 percent of the market.

⁴³ To further the enforcement of these conditions, the Department believes that the grant of authority to provide interexchange services should be subject to the following sanctions: *First*, that the Court should have the authority to withdraw the waiver if a BOC violates the equal access requirements of the waiver and of the Decree; and, *second*, that the Court reserve the authority to impose civil fines for violations. Proposed Order, § VIII(L)(5).

The Department does not believe that the BOCs should be prohibited from providing any interexchange services until they can demonstrate that competition would not be reduced were they allowed entry into interexchange services generally. The Department is aware of, and shares, the Court's concern about "piecemeal waivers." Triennial Review, 673 F. Supp. at 545; see also United States v. Western Elec. Co., 777 F.2d 23, 29 (D.C. Cir. 1985), but believes that wireless markets (as defined in the Department's proposed order) are sufficiently discrete to allay these concerns.

clarifications appear to be acceptable, though some clarifications may be necessary." (BOC Mem. 16) We discuss these issues in Section 1, pp. 31-36 below. The BOCs have, however, objected to the Department's resale and marketing restrictions. (BOC Mem. 16-19) We therefore explain our reasoning for those restrictions separately, in Sections 2 and 3, pp. 36-40 below.

1. The Department's Proposed Order Will Substantially Prevent

Discrimination in the Provision of Access.

The following specific terms and safeguards appear to be necessary and appropriate to prevent discrimination by a cellular exchange against competing interexchange carriers:

a. <u>Basic Injunction</u>. The Department's proposed order states explicitly the basic injunction necessary to protect against discrimination:

Each BOC local telephone exchange company and Wireless Exchange System shall offer to all interexchange carriers interconnection, exchange access, and exchange services for such access, on an unbundled basis that is equal in type, quality and price to that provided to any interexchange service provided by that BOC or any affiliate thereof.

Proposed Order, § VIII(L)(3)(a)(1).⁴⁵ This language, which paraphrases Section II(A) of the Decree, makes clear that the equal access obligation applies to cellular carriers and that the benchmark for discrimination is the access the BOC provides to itself, rather than what it provides to AT&T, the original language of Section II(A). Section VIII(L)(3)(a)(3) of the proposed order also makes explicit the implicit requirement of equal access, that the prices for

The Department's proposed order adds a new Section VIII(L) to the Decree. Section VIII(L)(1) contains definitions. Section VIII(L)(2) provides the authorization for specific interexchange services to be provided in connection with wireless exchange services. Section VIII(L)(3) contains specific equal access requirements related to that authority, Section VIII(L)(4) provides for the filing of compliance plans with the Department, and Section VIII(L)(5) specifies sanctions for violations of the modification or of equal access.

cellular exchange not vary with the interexchange carrier chosen:

A BOC or any affiliate thereof shall not sell or contract to sell Wireless Exchange Service at a price, term or discount that depends upon whether the customer obtains interexchange service from the BOC or any affiliate thereof.⁴⁶

In addition, the Department's proposed order explicitly makes Section II(B)'s requirements of nondiscrimination in the provision of technical information, interconnection and provision for planning of facilities binding on BOC commercial mobile service providers. The Department objected to the BOCs' earlier request to be allowed to give themselves preferential routing and colocation. The BOCs' proposed equal access plan as presented to the Court affirms that they will not give themselves those preferences. (BOC Model Equal Access Plan. p. 2) The Department believes that 60 days' notice of changes to the network is reasonably necessary to allow competing interexchange carriers sufficient time to modify their networks, and the BOCs have accepted that requirement. *Id*.

b. <u>Services from which Interexchange Service May Be Provided.</u> The scope of the proposed relief -- *i.e.*, the exchange services from which originating interexchange services may be offered -- needs to be defined beyond the use of the recently added statutory term

⁴⁶ Section VIII(L)(3)(a)(4) imposes an equivalent restriction on the sale of interexchange services; i.e., to the extent a BOC provides interexchange services to the customers of its cellular affiliates and to the customers of competing cellular affiliates, it may not vary the price depending on which cellular exchange service the customer buys. This requirement, which has been questioned by the BOCs (BOC Mem. 22), is necessary to give meaning to the unbundling requirement. Absent this constraint, the BOC could adjust the price of its interexchange service to create combinations of services that its long distance competitors could not match. Moreover, it would be decidedly procompetitive if the BOCs were to compete for long distance from each other's cellular exchanges and from McCaw cellular exchanges. A similar requirement is imposed upon AT&T and McCaw under the consent decree agreed to between them and the United States. AT&T/McCaw Decree. § IV.F.1.c.

"commercial mobile services." The Department proposes to use the term the following definition:

"Wireless Exchange Services" mean commercial mobile services, as defined in 47 U.S.C. § 332(d)(1); provided, however, that BOC Wireless Exchange Services are limited to services provided by corporations that have been established as separate subsidiaries from the BOC's local telephone exchange companies ("LECs"), and provided, further, that the principal facilities used to provide Wireless Exchange Services, including the MTSO and radio base stations, are physically and operationally separate from LEC facilities.

Proposed Order, Section VIII(L)(1)(c). The purpose of this restriction to "physically and operationally separate" networks is to distinguish wireless networks that are physically separate from the landline exchange, such as today's cellular networks, from networks that might be tightly integrated with the local exchange. It is unclear whether such a PCS service could be offered by anyone other than the local exchange itself, and therefore it might not be appropriate to allow BOCs to provide interexchange services from that network, just as it is not appropriate today for the BOCs to provide interexchange services from their landline exchanges, on these conditions. The BOCs based their proposal, and the Department evaluated this proposal, in light of current cellular architectures, and the Department therefore recommends limiting the waiver to commercial mobile services offered from networks that are fully distinct and separated -- both physically and structurally -- from the local exchange.

This term, added by the Omnibus Budget Reconciliation Act of 1993, Pub. L. 103-66, 107 Stat. 312 (1993), defines "commercial mobile services" as "any mobile service... that is provided for profit and makes interconnected service (a) to the public or (b) to such classes of eligible users as to be effectively available to a substantial portion of the public...." 47 U.S.C. § 332(d)(1).

As with the BOCs' proposed form of order, the waiver would not extend to interexchange telecommunications originated on cordless telephones or on "wireless PBXs," i.e., private mobile radio services provided within an office complex or similar environment. (BOC Mem. 12) The BOCs do not intend their relief to extend to the sorts of LEC-provided PCS services excluded by the Department's proposed order (BOC Mem. 12); the Department's proposal makes that limitation